DISCUSSION PAPER

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Third World Sovereign Debt Renegotiation 1980-86 and After: procedures, paradigms and portents

by

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Sovereign debt renegotiation in the first half of the 1980s has been carried on in a creditor dominated model in which full repayment and treating repayment as an overriding economic goal are taken as given and only secondary issues are in fact treated as negotiable. It is tied to the IMF high conditionality model. While the threat of an international financial system collapse has been averted, at least to date, the renegotiations have not laid a stable basis for a return to regular output and trade growth for debtors, or even globally. It is argued that the present model leads to negative sum games and that specific changes in it could yield net gains to debtors, the world economy, creditor economies and - probably - creditor commercial banks. The increasing resistance to, and attempts toward unilateral initiatives by certain debtors make negotiation of at least some of these changes both potentially possible and urgent.

THIRD WORLD SOVEREIGN DEBT RENEGOTIATION 1980-86 AND AFTER: PROCEDURES, PARADIGMS AND PORTENTS

Reginald Herbold Green1/

> The crisis in Africa in recent years is overwhelmingly the product of external shocks... Without the heavy post-1978 external blows or, given those blows, with adequate international buffers against them, the majority of African economies would not be sliding backward as they are now doing....
>
> \- G. K. Helleiner, 1984

> Insufficient finance leads to unwarranted exchange rate depreciation, restriction or debt default.
>
> \- Onno Ruding
> Interim Committee Chairman, 1985

> The preservation of the international financial system in its existing form and the mode adopted for debt crises management have had high costs not only for debtor countries but also for non-financial actors in the developed world.... financial interests, institutions and criteria have been extremely dominant in the way that debt crises have been managed.
>
> \- S. Griffith-Jones2/, 1986

> A resumption of net new lending by the commercial banks is in the common interests of the banks and their country clients... will facilitate the adjustment efforts... while... increasing the quality of the banks' own assets.
>
> \- J. Delarosiere, Managing
> Director IMF, 1986

Case by Case: But the Cases Have Altered

The period since 1980 has seen more renegotiation and rescheduling of sovereign external debt than the entire amount ever previously renegotiated. The pattern used was that developed over the 1960s and 1970s for dealing with sovereign debtor debt service crises on a case by case basis which -

with rare exceptions - increased rather than decreased the present discounted value of future interest and principal payments and allowed relief on current payment levels for quite brief periods (usually 18 to 36 months).

This retreaded 1960s-70s model is very different from the process which pertained during previous generalised external debt crises, e.g. that of the 1930s (Eichengreen and Portes 1985). Then the debtor governments defaulted. Over 1980-86, virtually without exception, creditor banks have avoided formally declaring a default (although they would often have been well within their legal rights had they done so). Debtors - even when in fact in severe arrears in interest on and repayment of sovereign debt - have been loath to declare formal selective or general moratoria, let alone defaults or repudiations. In these previous crises whatever renegotiation took place was after long default and - allowing for inflation and delay - creditors usually sustained heavy losses. The defaults and losses did not directly threaten the international financial system because the holders were predominantly not banks or other key financial institutions.

The Paris Club (government to government) and London Club (bank to government) renegotiating patterns were built up in the 1960s and 1970s. A substantial number of cases were handled, overwhelmingly of small, weak African economies with external debt levels which, while crippling in terms of service cost to the debtor, were an almost trivial proportion of the outstanding credits of banks and governments concerned on the creditor side. Further, these governments were exceptions - most debtors accounting for most sovereign external debt, even in Africa, did not find servicing impossible. In addition, most developing countries were able to secure a positive net flow of financial resources (new loans plus grants less loan repayments and interest payments).

As a result the creditor governments had very litle bargaining power. Default would wipe out their access to new loans (and grants) and cause trade credit to dry up, but would not seriously inconvenience the lenders. The fact of needing to reschedule was strong presumptive evidence either of external debt or other economic mismanagement and/or of a severe terms of trade or natural disaster shock. Further, in each case one small country with limited expert personnel sat across the table from a phalanx of big, well staffed goverments or banks.

Not surprisingly the results were that terms were relatively harsh: the period for which arrears, future repayments and - especially - interest were deferrable was short; the period over which these rescheduled payments were to be made good was rarely over ten years; the interest rates on rescheduled items were at least as high as their previous average. If it was felt that bad luck had played a large part in the debt crisis then the governmental creditors might put up a parallel soft loan or grant package but not negotiate it as part of the rescheduling. The one major exception to this pattern - the Indonesian external debt reconstruction managed by Herman Abs, which radically cut the present value of that country's debt - remained an isolated instance.

From Exception To Rule

In the first half of the 1980s this model has been applied to a very different group of creditors in a very different context but with unchanged basic characteristics (IMF 1983; World Bank 1986a):

a. not only have there been more reschedulings, but these have involved major debtors with outstanding sovereign debt much larger (often singly, let alone collectively) than the net worth of lending banks and even in the case of governments representing a substantial proportion of credit outstanding;

b. the world economy was growing feebly - or not at all - and world trade growth was very sluggish, thus raising doubts whether need to reschedule was presumptive evidence of prior mismanagement;

c. the net transfer of financial resources for Latin American debtors (a *fortiori* from the commercial banks) had gone into reverse with interest plus repayments exceeding new loans. In sub-Saharan Africa new loans plus grants, but not loans alone, did provide a declining net transfer. Therefore, rescheduling created no presumption of an early return to a net financial resource inflow.3/

However, because negotiations took place in the old format, the old conditions tended to remain. Short periods of deferral, relatively brief periods of subsequent repayment, no concessions of much significance on rates, one debtor alone negotiating against a phalanx of all major creditors remained the rule. There were some modifications:

a. the IMF was allocated a leading macro supervisory (enforcement) role by insisting that a higher credit tranche agreement with associated exchange rate, credit control and budgetary stringency measures was a precondition for Paris or London Club reschedulings (except for non-IMF members such as Cuba and Poland). Some selective net transfers to favoured Asian economies survived but even there doubts were growing. Getting out of or at least reducing exposure in developing countries was the medium term goal of growing numbers of commercial banks;

b. 'involuntary lending' by banks became part of most London Club reschedulings, i.e. new loans were provided for in the agreements at levels which reduced the net financial outflow by the debtor (i.e. covered most or all loan repayment by rolling over - de facto - into new loans and in most cases also covered a portion of interest due)4/ and - less systematically - similar provisions as to concessional loans and grants were built into Paris Club government debt rescheduling;

c. the sovereign debtors were convinced (coerced) into accepting liability for the external borrowings of enterprises (private as well as public sector) even if these had not previously been guaranteed by the governments on the basis that unless they did so their government and economy would be seen as uncreditworthy and no rescheduling agreed.5/

An Alternative Approach: The Enterprise Model

The model practised was not the only possible one. Indeed it contrasts very oddly with the one developed over the same period for restructuring commercial bank claims on large, troubled (illiquid or insolvent) enterprises at both national and international levels. That model is characterised by:

a. injection of net new money - often including net new bank money;

b. lowering of total interest charges on outstanding bank credit;

c. lowering the capital value of bank claims - usually by converting a portion of loans into preference or ordinary shares whose value (unless the company recovers) is highly problematic;

d. designing the overall package on the basis that it must be such as to allow a return to growth and profitability by the enterprise within a brief period on fairly cautious assumptions, and must both place real burdens (sacrifices) on all parties and give each of them (including in most cases existing shareholders) a real remaining value and a chance of future gains.

The contrast is striking, especially when one recalls that banks can put in a liquidator and wind up or sell off an enterprise while no truly analagous procedure is practicable today6/ with respect to sovereign borrowers.7/ What is surprising is how rarely this alternative model has been pointed to when evaluating the one used in respect to sovereign risk borrowers.8/

With What Results To Date 11/

The 1980-86 results of the case by case, creditor financial concerns centred, limited concessions debt renegotiation model are mixed (World Bank 1986; Commonwealth Secretariat 1982; UNCTAD 1981-85; Ffrench-Davies and Molina 1985). First, it has averted a collapse either of the international financial system or of major financial institutions. That is no small gain - a new Credit Anstalt debacle with an even remotely parallel chain reaction through the interntional financial system would have cost debtors and creditors alike a great deal. Second, it has preserved (at least on the books) high levels of profitability on sovereign risk lending while allowing a very limited degree of absolute additional (and a decline of relative) commercial bank exposure to catastrophic loss on such lending to developing countries. Third, that stability remains precarious - periods of apparent self congratulation that all is under control are regularly followed by renewed pending crises and hectic juggling.

From the point of view of debtors taken separately the results are much worse. While default has been avoided and formal creditworthiness maintained, this has been at the price of severe domestic demand compression (recession or depression creation) to create a trade surplus adequate to cover net financial resource outflows. There has been no return to net inflows (on combined capital and interest accounts) - the formal creditworthiness has not carried with it much willingness to extend net new credit - and the prospects for such a return to positive financial transfers have steadily receded like a desert mirage with the result that reschedulings have become sequential (not once-for-all) events.

Even for creditor country institutions and enterprises other than financial institutions the results have, on balance, been negative. First, the need to cut demand - especially demand for imports - by Third World debtors has radically reduced their resilience as export markets for OECD countries. By so doing, it has wiped out one of the buoyant factors which led to a rapid recovery after the 1973-75 economic shocks.

Second, by forcing the debtors to raise exports to meet debt service obligations (e.g. for Brazil to achieve the world's third largest trade surplus to cover - or almost cover - interest payments alone) it has fanned the forces of protectionism by creating very real problems of unemployment, capacity underutilisation and regional decline in the industrial economies. Arguably, the pressure to expand, or at least maintain, export earnings to service debt has contributed both to overproduction and weak selling in primary commodity markets.

Third, by creating a climate of economic uncertainty, it has undermined the initiatives of entrepreneurs and the optimism of state and central bank policy makers. Thus it has encouraged low investment and very cautious9/ overall fiscal and monetary policies which have tended to extend the depression and limit both the rate and stability of subsequent recoveries.

In short, the worst - a financial apocalypse followed by a deep and lasting world depression - has, to date, been averted. But no stable new basis for developing country sovereign debt flows or management and no trade context conducive either to stable recovery in the industrial (let alone the debtor developing) economies or to a return to rapid expansion of world trade has been achieved. Indeed, doubts as to whether the feared financial system crisis has been averted or merely postponed refuse to go away. On the most optimistic view they keep recurring, and on a more pessimistic interpretation they oscillate around a rising trend. Thus by the third quarter of 1986, Mexico was feared likely to move toward a *de facto* moratorium and South Korea, which had previously been seen as the safe Third World borrower *par excellence*, (despite high export and national growth and a record trade surplus) was argued by some semi-official and financial sources to be a high risk case.

Some Variations Around A Theme

The model sketched above is not monolithic. There are regional and national variants and some divergencies among rescheduling agreements (IMF 1983; World Bank 1986).

The *locus classicus* of the model is Latin America and particularly the larger South American states plus Mexico. This is true for three reasons. First, the bulk of commercial bank sovereign risk credit to developing countries is extended to Latin America and constitutes the major part of Latin America's access to external financial flows because concessional finance is very limited on non-concessional governmental (export credit) and international financial institution (World Bank, Inter-American Development Bank) flows are substantial but much less than commercial bank ones. Second, except for a few smaller economies where aid and/or IBRD/IADB lending is a higher than average proportion of flows, Latin America has been characterised by net negative financial transfers, at least from 1982. Third, the real threats Latin American defaults could pose to the international financial system have concentrated attention on this region and made 'solutions' arrived at there the norm for use elsewhere.

China and India are special cases. Neither is heavily externally indebted. Neither is viewed as a serious credit risk and both enjoy net financial inflows.

Asia - excluding India and China - has not to date been prominent in debt rescheduling. Indeed the 1960s and 1970s model of rescheduling needed only for the exceptionally unlucky or ill managed economy - e.g. the Philippines whose experience is analagous to a second tier Latin American economy - has continued to apply. This may not remain the case. Net financial transfers for the region have probably gone negative - certainly have on commercial bank account. The 1985 economic outturn of the previously high growth/strong external balance group (South Korea, Hong Kong, Taiwan, Singapore, Thailand, Malaysia) is much poorer, with 1986 prospects, except for Korea, also relatively poor. If - as in Latin America over 1980-82 - this weakening of results and prospects leads to precipitate bank attempts to reduce exposure there will (as a result of lemming like banker behaviour) be an external debt crisis, notably in the case of South Korea.

Sub-Saharan Africa (Green and Griffith-Jones 1985; World Bank 1984; Lancaster and Williamson 1986) is a special case as a region because concessional finance and international financial institution credit - not commercial bank loans - are dominant for the region and for a majority of countries. Therefore, its net financial transfers have remained positive. By the same token it is in a weak bargaining position because continuation of net inflows is critical and in one debtor/all creditor negotiations African states are very much outgunned financially and in terms of expertise. However, the net financial transfer is falling very rapidly (has gone negative on private flows and is falling sharply on inter governmental and IMF account) and - including interest payments - may well be negative by 1986 unless a sharp reversal of the post 1980 concessional finance decline trend takes place. IMF data indicate a net transfer of $6,900 mn in 1979 falling to $200 mn in 1985 with a possible 1986 out-turn of -$1,200 mn.

Equally there has been some difference in treatment of debtors who are very large or have the 'protection' of a major power in their dealings with the Paris and/or London Clubs. In the first set of cases the debtor government has an analogue of 'mutual assured destruction' to use in negotiation because its default would both directly and by chain reaction do totally unacceptable damage to the creditors. Individually, Mexico, Brazil and Argentina have this power. Collectively the Cartagena Group would hold it to an even greater degree if it were to agree to embark on collective or fully coordinated action. In the second set, the political or economic interests of a major OECD government have led to more optimistic and credit granting results than the inherent economic prospects or economic management of the country would otherwise have produced. The most evident cases are the Sudan, Zambia, Zaire, Jamaica and the Ivory Coast.10/

A third special category - cleary solvent but temporarily illiquid economies - is more problematic. The most evident case is - or at least was, until the 1986 oil price collapse -

Venezuela and the only evident gain it secured was a rescheduling (at rather more parsimonious interest rate and payment delay levels than normal) without a prior IMF agreement.

There have also been some divergencies in terms of specific reschedulings. A few countries have rescheduled several years' principal repayments at one go. Another handful have somewhat reduced the commercial bank interest rate spreads above LIBOR charged. The period over which rescheduled amounts are to be repaid has varied. Similarly the extent of 'forced lending' to cover part of short term interest payments and the size of IMF credits and/or new World Bank and government concessional funding has varied. It is just possible to argue that a trend to longer periods, more 'new' money (i.e. loans partly off-setting interest) and greater attention to limiting net financial resource outflows exists. However, if so, that trend is very weak, sluggish and uneven.

The variations are not trivial from the perspective of individual debtor countries. But at the global level they are distinctly marginal and - if seen as a trend to adjusting the rescheduling model to changing contexts - lag far behind the events to which they are responding both in speed and in degree.

Some Limitations Of The Model

The weaknesses - as well as the strengths - of the model flow from the fact that it is very creditor centred. The context of all creditors versus one debtor; the acceptance of the premise of full recovery of principal and interest (with at most marginal concessions on the latter) and therefore of defence of banks' profit flows as well as assets; and the implicit premise that debtors should place debt servicing in the position of an overriding economic policy goal, whatever the cost, together combine to create a situation in which the details of time to pay and of interest and other charges - plus degree of rollover (so called new money or involuntary lending) - are about all there is to negotiate. The model itself assumes the outcome on all the more basic parameters.

From this approach flows the fact that debt renegotiation does not focus on acceptable time periods and rates of recovery of the debtor economy. The reason creditors bridle at questions like President Nyerere's as to whether he and similarly placed heads of state should pay interest, not import grain and therefore let people starve is that the logic of the present model does indeed provide a clear answer - pay the interest and the devil take the hindmost.

Unlike the enterprise reconstruction model, the sovereign debt model does not focus on the structural adjustment and rehabilitation of the sick economic unit, and it therefore cannot ask questions about minimising total present losses and maximising potential future gains, nor can it go on to evaluate how these gains and losses can be divided. Had Chrysler been treated on the sovereign debt renegotiation model it would have been liquidated at the nadir of its losses. Shareholders would have been wiped out (as would many workers and communities), preferred creditors might have recovered half their exposure and ordinary creditors a quarter. In blunt terms the present sovereign debt renegotiation model assumes a zero, not a positive, sum game and lays down rules of play which create the probability of the actual result being a negative sum game (Griffith-Jones 1986; Zartman 1978).

The typical - and much criticised - features of the model are as follows:

a. short deferrals and relatively short periods to repay them;

b. no re-scheduling of amounts renegotiated once;

c. no significant cuts in interest rates or fees;

d. no ceilings on maximimum financial resource outflow or maximum period before net positive inflows are to be restored;

e. absence of safeguard clauses against other capital movement leakages (e.g. running down revolving trade credits, short term deposits) wiping out the supposed gain;

f. lack of provisions for renegotiation (or formula adjustment of payments - i.e. a bisque clause - if external contexts and events are not as the negotiators assumed)

These are not separate, secondary elements. They are integral to the overall approach and within that approach can be toned down but neither phased out nor transformed into a positive sum game set guideline.

And Its Worldview

The all creditors/one debtor/all to be repaid approach leads to standard prescriptions well beyond the immediate debt deferral, repayment, interest rates and charges ones. The most important is the ubiquitious precondition of an IMF higher credit tranche agreement.

The immediate reasons for this precondition are more complex than any demonological view. Bankers may see the IMF as primarily a debt collection enforcement agency. It is doubtful that they really do understand and believe in the IMF's pure macro-monetary adjustment model (Williamson 1983; Green 1986). Rather, bankers have found that macroeconomic policy by a debtor can make performance of its rescheduling agreement impossible and that banker ability to negotiate and enforce a broad macroeconomic policy package (tried relatively unsuccessfully with Cuba and radically so with Peru) with sovereign risk debtors is very low. Further, over 1960-80 most reschedulings did relate to mismanaged economies or ones suffering from atypical economic shocks. The IMF was - and is - a body created to help buffer adjustment to or stabilisation across shocks and to offer macro monetary (external and internal balance) advice. It is in this context that it makes credits (drawings) available to its members on negotiated terms and conditions. Since this conditionality is intended to be adequate to secure a return to economic balance and (less clearly) growth, it is not unreasonable for debtors to assume it would also be relevant to restoring ability to service debt.

The difficulty with this approach is that the IMF operates on a rigid model which abstracts both from specific contexts and from the real (physical) aspects of the economic process. As a result, it seeks to impose uniform policy packages which often do not fit and which are very short term and monetary balance focused. Whether they are in general - let alone in all cases - consistent with achieving structural adjustment and future growth is, at the least, highly problematic (Green 1986).

Worse, the IMF model of stabilisation is based on domestic demand and import compression and export (and debt service11/) expansion. Like the sovereign external debt renegotiation model, the IMF model tacitly assumes that countries with severe imbalances are in a minority and that their imbalances result largely from clearly identifiable and both readily and speedily reversible macroeconomic policy errors. Whatever the validity of this view over 1960-80 it can hardly be accepted as a valid description of the 1980-86 situation.

Imbalances have been the rule, not the exception. Therefore to urge domestic demand and import compression plus export expansion as a recipe in each case adds up to a global macroeconomic impossibility on the trade side. One country's imports are another's exports. One cannot in general cut the former and raise the latter, even though any one economy may be able to do so. On the demand side it is a mechanism for deflation in the midst of a depression (perverse countercyclical policy). Thus - in a global depression or slow growth context generally and for some economies even in other contexts - the IMF model is as poorly oriented to creating a positive sum game context as is the present debt renegotiation one.

Blind Spots And Conditions for Sustainability

Clearly therefore, neither the sovereign debt renegotiation nor the IMF model really addresses itself to the conditions conducive to stable external debt managing and servicing:

a. moderate to rapid output growth globally and in specific debtor countries;

b. facilitating rapid expansion of global trade with

c. an adjustment of production in creditor countries allowing space for more imports from debtors;

d. creating room for debtors to service external debt out of export earnings without savage reductions in imports, and

e. also recreating a context of confidence in normal servicing of debt with individual loans repaid when due that will result in a reversal of the present net transfer of financial resources from Third World debtors.12/

Indeed, as they now operate the models make attainment of each of these conditions harder, not easier.

This is particularly serious - not least from the creditors' point of view - because the basic conditions for survival of the present sovereign external debt and rescheduling structure include stable four to five per cent a year growth of OECD economies and five to six per cent a year growth of world trade (including debtor exports to creditors).13/ These conditions have not both been met in any year since 1979 and no serious economic forecast shows them as likely to be met over 1987-90.

As a result the 1980-86 rescheduling process has been kept going only by hectic juggling and patchwork on major cases and a growing number of fudges or blind eye turning to what amount to defaults.

Bolivia for example has long said - correctly - that it cannot pay or reschedule on available terms. This has been ignored. So was Peru's effective limitation of interest and repayment on medium and long term official external debt to ten per cent of export earnings until President Garcia enunciated it as a principle. Many smaller, weaker African debtors have huge trade credit and more conventional debt service arrears - in several individual cases exceeding $500 mn. Even arrears of over $200 mn each to the IMF by the Sudan and Zambia were for extended periods quietly kept out of the headlines, while attempts to reconcile the principle of the sanctity of debts (especially to the IMF), the reality of no foreign exchange to pay and the need to avoid a precedent setting/system shaking default or forgiveness of debt were juggled ever more frenetically backstage. Failed IMF, Paris and London Club programmes - e.g. Sudan, Zaire - have regularly been given new coats of paint (or more literally, new, hopelessly unrealistic economic policy and outcome projections) and presented as new ways forward (or even part of an ongoing, partly successful process!) to avoid a precedent setting collapse.

The handwriting is on the wall. The 1980-86 model is working increasingly fitfully, unevenly and partially even in respect to the only area in respect to which it has been successful - avoiding major shocks and threats to the stability of the international financial system. On existing economic projections it can be expected to encounter more problems, not less, over 1987-90. Meanwhile, the debtors counting the domestic costs of enforced domestic depression and the ever retreating vision of restoration of net financial inflows are ever less willing to continue paying the bulk of the global price of holding together an international financial system they never made and which never operated primarily for their benefit.

These comments on weaknesses of the model are not directed to dividing up blame for the debt crises. The criticism of banks that they encouraged governments to take up loans at then negative real interest rates for poorly defined purposes (in one case raising real public service wages while the real price of the economy's basic export and production sector fell with no foreseeable recovery) is true enough. So is the counter argument that the governments should have had more sense. The criticism that the same banks that lent the sovereign debt were in many cases the channels by which private individuals expatriated comparable sums which give nominal (and only nominal, not operational) balance between public external debt and private external assets is valid. So is the counterpoint that many of these flows (e.g. in the case of Mexico) were legal and the others (e.g. in the case of the Argentine) required debtor state complicity as well as bank facilitation. Clearly balances of fault do have a certain impact at or even beyond the margin on negotiations. This is especially likely to be the case where a new, popular government can say the debt incurred by an overthrown military or other dictatorial predecessor gave no or little value to the borrower; that payment would - on present or comparable terms - exact unbearable domestic costs; and, therefore, that the government is politically unable as well as unwilling to pay - at least as scheduled. But such factors are usually secondary and very country specific. Further, the two evident debtor governments able to deploy them - President Alfonsin's in Argentina and President Aquino's in the Philippines - have been surprisingly reticent about doing so.

The more general case is that:

1. an external sovereign debt crisis exists which if not resolved will do very grave damage to creditors, debtors,

the national economies of both and the international economy;

2. in part this relates to neither borrowers nor creditors having envisaged the actual 1980-85 global economic scenario correctly (a 'fault' they share with each other, industrial economy governments, OECD, IMF, etc.);

3. and in part to imprudence (and in some cases malpractice) both by lenders (banks and governments) and by borrowers;

4. therefore the overriding common interest is in minimising the sum of present losses and maximising the pace and level of future gains/recoveries;

5. with the secondary requirement of achieving an acceptable division of those gains and losses among the parties involved.

An inquisitorial or adversorial proceeding of a quasi criminal type is not very likely to be a large part of the solution to these problems.

Nor do the foregoing comments on weaknesses imply that bankers are unaware of basic as well as surface defects in the present model, even from their own perspective.

For example, in late 1984 a vice-president of a major international bank outlined his nightmare to the present author. It was that in negotiations the banks would successfully press a Brazilian delegation so hard as to secure a package so 'good' for the banks and so damaging to the Brazilian economy that it would result in the firing of the Brazilian negotiators and a radical swing to a Brazilian initiative take it or leave it strategy. He wanted the academic community to warn when that danger point was approaching. The answer he got, that in the case of Brazil the banks were already beyond it and needed to pull back fast, did not console him. But, one may suspect, the fact that within six months a 'successful' Brazilian negotiating mission to the IMF and the banks was fired on arrival home and the new Brazilian government steadily redesigned and hardened its model for debt renegotiation did not very greatly surprise him, and may have saved his and other banks a good deal of grief and money.

The current case - as of late 1986 - of a danger of banks insisting on 'doing too well' and precipitating a crisis is Mexico. Unless and until there is a sustained petroleum price recovery to well over $20 a barrel, Mexico cannot possibly meet the bulk of its interest payments and reverse the post 1982 decline in GDP per capita. With the strains on and cracks in its social and political fabric already plain to see, enforced continuation of contraction is likely to have very severe costs, not only for Mexicans but for creditors and neighbouring states.

Toward Debtor Initiatives

Over 1983-86 debtors have had a rising consciousness of the costs of standard model debt renegotiations tied to standard IMF adjustment programmes. In addition they have seen ever more clearly that no early return either to positive net resource transfers or to easy export growth was foreseeable. As a result they have become less and less willing to bear the bulk of the burden of holding up the international financial system and the profits of the major banks. Indeed, some have come to see 1980-85 model rescheduling as being a holdup in the sense of an armed robbery, not merely that of Atlas holding up the world on his shoulders.

This has led to a growing number of what amount to unilateral initiatives and/or proposals for renegotiation within parameters set by the debtors. With the possible exception of Peru's trumpeting of a ten per cent of exports debt service ceiling, all appear to have been phrased with a view to shocking creditors and hurrying them into negotiations before still more unpalatable take it or leave it offers were made, but also phrased in a low enough key to avert a wholesale, instant financial panic.

Two of the initiatives are regional. The Latin American one has a pre or parallel history in SELA (ECLA) technical papers and discussions but, in fact, no really innovative official proposals have emanated from that source as yet. The Cartagena Group (the major debtors) has to date played a background role using its existence as a periodic forum to pose the threat of a 'debtors' cartel' without actually becoming one and issuing statements implicitly threatening collective action when a major member was in particular difficulties with its renegotiation. However, in 1985 and again in 1986 it apparently began to move toward a more substantive role issuing statements on the need for reduced net outflows and increased access for exports while in 1986 giving a tepid welcome to the Baker Plan as in the right direction but too cautious and too small. However, the Cartagena Group today has not followed up collective statements with coordinated action to support its most exposed members - Argentina in 1985, Brazil in 1986. Until it does so the value of successive forceful statements wil gradually erode.

The African position - taken at the 1985 OAU Economic Summit largely on the initiative of its outgoing Chairman, Julius Nyerere - is somewhat clearer and attempts to be more active than that of the Cartagena Group. It calls for a conference of all African debtor states with all major creditor states to discuss basic parameters for substantial reductions in debt service payments (implicitly for an extended period) and for substantial increases in the net financial resource transfers to Africa.

This position relates to certain special features of the African case. Governments, not banks, are the major creditors (and together with international institutions the only likely sources of net inflows); aid is substantial absolutely and relative to debt service; while rapidly declining, the net financial flow balance is still positive. As President Nyerere put it at Mansion House, London, in April 1985, Africa is too poor to refuse to pay (and lose all credit and aid) but equally too poor to pay on present terms and conditions (which would soon lead to a net outflow).

The African proposals to the UN Special Session in May 1986, called for over $35,000 mn of reduced debt service payments over 1986-90 and for agreement on a general framework on debt rescheduling. The final resolution ignores the quantitative aspect and calls only for flexibility within a framework of case by case rescheduling. However, the Chairman of the Non-Aligned Movement, Robert Mugabe of Zimbabwe, re-raised the issue most forcefully at the September 1986 NAM Conference in Harare and the Organisation of African Unity is still seeking to achieve a creditor-debtor conference for Africa.

National Gambits -

Over the past two years a number of debtor countries have acted openly and formally to reduce their debt service burdens in ways very different from the standard rescheduling model. All have stopped well short of repudiating their external sovereign debt or even stating that it was, and would remain in, default. Almost all have sought renegotiation - but on their own terms. Each national gambit differs in certain respects from the others - sometimes, but not always, for reasons which clearly relate to contextual or country specificities of the debtor.

Bolivia was the first country to declare openly and formally that it could not pay principal or even all interest due. By itself this created little stir. Bolivia clearly could not pay, had limited bank borrowings and if ignored would - the creditors hoped - not set a precedent.

Peru, however, has alarmed creditors much more. In late 1984 the Central Bank (at that point in opposition to stated government policy) began limiting debt service payments to what it believed could be afforded after meeting minimum import needs, i.e., treating them as a residual (or deferred creditor) not a top priority (or first charge) item. This aroused little open bank reaction until - following elections - President Alan Garcia formalised and publicised this policy, setting an external debt service ceiling for medium and long term of ten per cent of export earnings and, at least implicitly, raising this as a standard for other sovereign debtors to rally around.

The announcement that the international development organisations (IADB, World Bank, but not the IMF) were to be paid on schedule meant not only that Peru would be able to pay little interest (let alone amortisation) on commercial bank (or bilateral government) loans but that it was asserting the right to treat creditors unequally (a cardinal sin under Paris and London Club rules). This was aggravated by the fact that Peru has both kept revolving trade credits with a selected group of banks current and is using that device to limit the problems with financing trade flows which, assertedly, would follow from even a partial unilateral moratorium, while also building up its useable external reserves to over $1,500 mn.

The first African case which marked a clearcut unilateral initiative was - ironically - the Republic of South Africa in mid-1985. The combination of poor economic prospects and the hassle (and business loss) factor of dealing with the apartheid economy led US banks to seek to pull out by non-renewal of all maturing loans.14/ While RSA has a current account surplus it also has a short external debt time profile and could not repay if the flow of new credits stopped. It therefore declared a moratorium or 'automatic rollover' on all external loans (except, one assumes, the IMF) and has negotiated on the basis of no or virtually no net capital repayment.

Nigeria's initial (1984) rescheduling efforts were unusual only in that the government declined to enter into an IMF agreement. Beyond that the Nigerian proposals were quite within the model - over 40 per cent debt service was apparently seen as acceptable. In 1986, however, Nigeria announced a unilateral 30 per cent of exports ceiling (adequate to cover all interest and perhaps half of capital account repayments) and called on creditors to negotiate individually or collectively within that parameter.

However, the greatest tremors to date probably flow from Brazil's 1986 actions. First, it insisted on a two year rollforward of revolving trade credits and short term deposits totalling $16 bn without an IMF agreement - implicitly threatening a moratorium in all other debt if the $16 bn was, to any substantial extent, withdrawn. Second, it declined to reimburse the external creditors of two failed private sector banks in full or on terms markedly preferential to domestic creditors (external creditors received about 67 per cent and domestic about 50 per cent). As Brazil has a large current account surplus before interest as well as $100,000 mn odd of external debt, it has had unusually strong leverage and has secured grudging *de facto* acceptance both of the rollforward and of the partial payment.

The Mexican rescheduling package begun with the third quarter 1986 Agreement may also become precedent setting, but is still ambiguous in its outcome and implications. The IMF agreement does have a de facto bisque (or exogenous contingency) clause. If the export price of crude oil fluctuates below (above) a set range, the drawings and the government borrowing limit will automatically be increased (decreased). The value of this apparently precedent-making provision to Mexico may be limited as the price below which it would receive additional drawings is significantly below the September 1986 level which is itself disastrous for Mexico.

On the commercial bank side, Mexico is demanding substantially lower interest rates (significantly below the US prime rate) not re-lending or rolling forward interest. But its statements appear - not only to commercial bank ears - to fall short of saying it will enforce such cuts unilaterally if creditors refuse to negotiate them. In the meantime there appear to have been substantial slippages in levels of short term deposits with and revolving trade credits with Mexican banks.

- and Creditor Pre-emption Attempts

Creditors - or at least some creditors - have also begun to have second thoughts about the continued viability of the 1980-85 debt rescheduling model. The reasons appear to be fourfold:

1. its import reducing impact on debtors is bad for global and OECD economy export and GDP growth;

2. its export forcing impact creates severe protectionist lobby problems in OECD economies plagued by the highest relative unemployment rates since the 1930s;

3. the constant juggling needed to keep it in place is nerve-racking and resource demanding as well as suggesting that at some point a major default will not be barely averted but will actually happen;

4. increasing debtor self assertion implies that the risks of a head-on confrontation are rising unless changes are made reducing their net financial transfer outflows and increasing their short and medium term growth prospects.

The major pre-emptive initiative for combining standard rescheduling with growth has been the Baker Plan launched by the US Secretary of the Treasury at the 1985 Fund/Bank Annual Meetings. Its main features are: $20 bn in additional new commercial bank loans to key developing countries following 'responsible' policies, complemented by a similar amount of additional World Bank lending (presumably largely to the same countries), plus recycling of the IMF Trust Fund to reduce net repayments to the IMF by low income countries pursuing IMF programmes but facing longer external balance adjustment periods than IMF drawings are designed for.

Secretary Baker's proposals were a serious attempt to marry conventional debt rescheduling and IMF stabilisation to revived growth by at least many developing economies and thereby to bolster the growth of world trade. They would, of course, help raise US exports (and reduce protectionist pressures) and safeguard US bank loans, but they do have a broader set of goals as well.

However, they are problematic at three levels. The sums are too small to achieve the stated purposes for more than a handful of countries. Indeed, arguably, the global total would be inadequate to cover 1986-90 requirements for Mexico alone. Further - except for the Trust Fund recycling - they virtually exclude low income countries (unless and until the USA backs, and delivers its pledges to, a sharply expanded IDA). Third, the proposals had a heavy dose of cross conditionality including both IMF vetting for fiscal orthodoxy and US testing for adequate concentration on promoting the private sector, including its foreign members. Secretary Baker was clearly seeking (and to date failing) to achieve a conservative, pre-emptive strike to head off any basic changes in the renegotiation model by lessening (but by no means eliminating) the net burdens it imposes on debtors.

IMF Managing Director, Jacques Delarosiere, has firmly adumbrated a similar approach:

> While it was inevitable, and indeed essential, for the banks to scale back their lending from the unsustainable levels recorded up to 1981, the recent trend has been toward a too rapid disengagement - one that if not reversed could undermine the efforts of countries making progress toward adjustment. (Delarosiere 1986)

Toward Positive Sum Game Renegotiation?

Fairly clearly, changes from the 1980-85 debt renegotiation model could be desirable for all - or almost all - parties and are also inevitable. While only partly responsive to debtor needs and largely in the context of the old model, the Baker proposals did and do represent some flexibility and a realisation that the present approach to debt renegotiation has high present and higher potential costs to the global and creditor economies.

A positive sum game model can be worked out - e.g. by analogy to the enterprise restructuring model sketched above. However, by definition it cannot be achieved without at least a substantial degree of cooperation among creditor and debtor governments plus, preferably at least, the tacit consent of the IMF and the commercial banks. For debtors to attempt to impose unilateral solutions (or creditors to face debtor initiatives with the Baker Plan and no more - or a watered down Baker plus economic assaults against obstreperous, medium sized debtors like Peru) would lead to confrontation exceedingly likely to result in an international financial and trade system crisis amounting to partial collapse. That would be a very negative sum game indeed.

The first logical debtor proposal would be to reverse the present 'case by case' negotiations by all creditors with each debtor separately to enforce a basically uniform creditor built rescheduling model:

1. basic guidelines should be negotiated among all major debtor and creditor governments (or alternatively with separate Latin American, African and - potentially - Asian debtor groups) with IMF, World Bank and Commercial Bank representation;15/

2. on the basis of these guidelines, country settlements should take into account the special conditions applying to that particular debtor country.

A second step would be to treat global output and trade growth as just as important goals for the macro debt renegotiation process as avoiding major shocks to the international financial institutions. The corollary is that any national rescheduling should be within the parameters of making possible return to positive real per capita growth of GDP and of earned import capacity (i.e. purchasing power of exports) within three years.

Third, some form of ceiling on net financial outflows (including interest) or floor on net financial inflows - presumably relative to exports and possibly GDP - should be set. The simple form of X per cent of export earnings for gross debt service is not, in fact, satisfactory except in the extreme case of no new loans. A more general version would apply to net debt service (interest plus repayments less new loans and grants). A more ambitious formula would be immediate or binding (as opposed to hortatory or cosmetic)target date achievement of nil outward transfer (i.e. interest offset by new loans and grants). A still more ambitious step would be to set minimum positive inward transfer.

A uniform formula is not practicable. Sub-Saharan Africa as a whole and virtually all of its economies need positive inflow targets if GDP growth at least equal to that of population is to be achieved. Some - though not all - Latin American economies seem prepared to accept a maximum net outflow target, at least for several years. This may suggest a case for separate African and Latin American negotiations (albeit Bolivia, Paraguay and some Central American and Caribbean economies also appear to need net inflow floors, not outflow ceilings). If that is the case general criteria are needed to define the characteristics which lead to net inflows, net balance or constrained net outflow targets.

How to achieve these targets is perhaps a less crucial and certainly a consequential issue. Interest rate reduction; enhanced new loan and grant levels; quasi automatic rollovers and multi-year deferrals of debt service with long subsequent payback periods could all play useful roles in at least some cases. An ample literature has explored them - singly and collectively - in great detail but, to date, remains peripheral to the actual negotiating process.

A more critical demand would be for guidelines for automatic rollforward of payments due if mutually unanticipated events (including global economic trends and natural disasters) make initially agreed target levels inconsistent with growth floors. Recent Mexican and Venezuelan agreements and proposals go some way toward this goal, but only for heavily indebted petroleum exporters dependent on oil price stability/recovery.

Finally, in the cases of extremely indebted poor and middle income countries the present discounted value of future debt service needs to be reduced. This need not necessarily imply writeoffs of principal. Extended repayment periods at lower interest rates could have the same effect and might create less immediate problems for bank balance sheets even though they would reduce future bank profit flows.

A rational creditor response pattern - i.e. one aimed at achieving an agreed, positive sum game outcome might include acceptance in principle of multilateral guideline setting but proposing a less than optimal forum, e.g. the Fund-Bank Interim Committee, and exclude binding acceptance of the guidelines by the London and Paris Clubs. The venue problem is real - UNCTAD is clearly unacceptable to the creditors and a Fund-Bank Committee is not a truly neutral venue from a debtor perspective. Conceivably an ad hoc G77-G10 committee with a joint secretariat might be viable. The experiment with Committees of 'Wise Men' is not very conducive to faith in this method, unless the members were serving senior Ministers of Finance, Central Bank Governors and Commercial Bank Presidents. While there is no evident way to make the guidelines equally binding, they certainly should be accepted as binding government delegates to the Paris Club, and maximum arm-twisting used on the banks who comprise the London Club.

In principle the creditors should have no objection to building global and national GDP and trade growth targets into rescheduling. The counterproposals would seem likely to turn on target rates, on what was to happen were these not achieved and on whether they should be formally included in the rescheduling agreement documents.

Maximum gross debt service ratios will certainly be challenged. Net ones on a country by country basis might be seen as acceptable. For example, the final resolution unanimously adopted by the UN General Assembly Special Session on Sub-Saharan Africa did accept that no creditor government should have a net return flow of interest and principal over new loans and grants to any SSA economy in serious financial trouble. Any general breakeven or positive flow target will be strongly resisted, possibly with the exception of least developed or low income debtors. Further, at this point - if not before - issues of policy conditionality will be raised. This is logical if they relate to trade balance evolution, less evidently so if they lay down uniform criteria for domestic macroeconomic policy.

On how to achieve targets, creditors would probably have the least objections to multi year deferral and extended repayment plus more new loans in general, and to more concessional finance for least developed or low income countries. Reduction of interest rates will be opposed with the conceivable exception of interest on rescheduled debt.16/

Automatic adjustment guidelines/formulas to relate payments to global or other external economic devlopments will be resisted. Commitments to renegotiate in good faith - especially in respect to sudden interest rate surges or key export price falls - may be proposed as an alternative with the not unreasonable proposition that if results are much better than anticipated, then advance repayments on a portion of rescheduled debt should be envisaged.

Writeoffs are likely to be opposed - the only recent precedent is the 1960s Indonesian rescheduling. However, in respect to low and lower middle income economies including a significant number in Africa - which clearly cannot pay the present discounted value of their debt on any rational projections, a combination of increased concessional finance and *de facto* substitution of low interest government to government loans for a portion of maturing (or *de facto* defaulted) non-concessional loans might be acceptable. Both John Williamson reviewing the Institute for International Economics' 1986 'African Debt and Finance' Conference and the World Bank reviewing how adjustment with growth might be achieved in SSA came to the conclusion that at least for a dozen countries external debt was unmanageable (Lancaster and Williamson 1986; World Bank 1986b). The Bank, in fact, fairly clearly argues that once these countries enter into serious structural adjustment efforts, they should be supported by very substantial *de jure* or *de facto* external debt writedowns.

Much more marginally - but also more generally - some reduction in present discounted value of debt service via lower interest rates on rescheduled/rolled over debt might also be acceptable. In this context a counterproposal is likely that if results within a given period are above mutally agreed projections then a portion of that gain would go to creditors who have accepted interest rate or principal sum reductions. This would be an analogue to the equity for loan tradeoff aspect of the enterprise model.17/

Such a set of counterproposals is the most which can plausibly be expected from creditors, and that only after preliminary attempts to respond with a much more restrictive set. They do have a substantial margin of divergence from the logical debtor demands. However, that margin would appear to be a negotiable one and one which sets negotiating parameters within the range likely to produce positive sum game outcomes.

Notes

1. Professor Green is a Fellow of the Institute of Development Studies at the University of Sussex. He has written extensively on adjustment and on sub-Saharan Africa's external debt and is currently collaborating in a debt renegotiation research project led by Dr. Stephany Griffith-Jones for whose comments on an earlier draft of the present paper he is grateful.

2. The sections of the present paper reviewing the 1980-85 renegotiation model draw substantially on this paper and on discussions with its author.

3. There is a debate on when and whether net inflows - which are normal historically for a developing economy or a growing company - are likely to resume. See, e.g., Cline 1984.

4. For banks as a group the 'new' loans were a low price for averting default. As they represented only part of interest, the net cash flow was to the banks.

5. Whether this is a new feature is not clear. In the 1960s and 1970s reschedulings, very few non-guaranteed private sector borrower loans were outstanding. An odd echo of this point arises in the case of the insolvent International Tin Council. The Council is an independent, intergovernmental legal entity. Its liabilities - from failed tin market management - exceed its assets. Bank creditors demand its members meet the deficit (as do metal brokers who face real bankruptcy risks otherwise) which it is by no means clear they are legally obligated to do. Oddly enough the developing country members were at one point willing to pay, but Germany, Japan and France led opposition to a bail-out operation.

6. Presumably gunboat debt collection, literally putting in a Treasury/Central Bank receiver and manager at gunpoint, is no longer practicable.

7. Seizing external assets of debtor states - and especially exports and imports - is usually laborious, uncertain and quite inadequate in proceeds to service debt.

8. A former TNC senior manager who had apparently specialised in turning around ailing overseas subsidiaries, remarked as a new ambassador that he could not understand creditor/IMF logic in a specific case. They appeared to want de facto to liquidate the economy - which as a company doctor he had always viewed as a last, not a first resort. And, in any

event, liquidating a national economy for the benefit of creditors was not possible.

9. On fiscal policy the USA is an evident exception; on monetary policy (partly consequentially) it is very restrictive indeed.

10. In all but the Ivory Coast these comments apply particularly forcibly to the IMF. The USA has been the presumptive 'protecting' power in all but the Ivoirian case.

11. In all fairness the IMF sees itself much more as a systemic platonic guardian than as a debt collection agent for commercial banks and, indeed, rather resents being given the latter role.

12. See, e.g. Cline 1984. His cutoff rates are 3.5 per cent for OECD and about 5 per cent for world trade growth.

13. This represents a broad summary of the conclusions of analysts such as Cline (op cit) who are optimistic about the survival of the structure.

14. The attempted withdrawal of credit was to public and private enterprises as well as to the government.

15. Clearly not all actors can participate directly in actual negotiating sessions, as mob scenes, not negotiations would ensue. Representatives would need to be selected, e.g. the G24 for the debtors.

16. Banks do not have to lend at LIBOR to break even. Their average cost of funds is much lower. On a scheduled loan which would otherwise be defaulted it is hard to see a case for an interest rate higher than the average cost of funds to the lender.

17. Actual transactions involving conversion of external public debt into foreign private equity investment are taking place - especially in Chile and Mexico. (See, e.g. International Herald Tribune, 12-IX-86, 'Latin Countries Turning to Debt-for-Equity Swaps.') However, even though such exchanges may have reached $1,000 mn by late 1986 and on some estimates have a potential of $10,000 mn this is very marginal in comparison to about $1,000,000 mn Third World external sovereign debt.

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